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LIABILITY TO THIRD PERSONS OF ASSOCIATES IN DEFECTIVELY INCORPORATED ASSOCIATIONS.

THE principles underlying the obligations to third persons of the members of defectively incorporated associations, are few and not difficult of apprehension. Yet there is hardly a topic in the law of private corporations upon which the views of both courts and theoretical writers are in more disagreement. This disagreement is concerned largely with three questions, namely: What is the basis and scope of the doctrine of *de facto* corporations? Are persons dealing with the associates on a corporate basis estopped to deny the corporate character of the association? Are the associates *ipso facto* liable as partners? Upon all of these questions there are various shades of opinion. The *de facto* doctrine, while of recent growth, is well established in American law, although some writers still deny its existence as a separate doctrine, and it finds no support in the English cases. But notwithstanding that the American courts almost universally accept the doctrine, there is disagreement as to its scope. According to the weight of opinion the doctrine does not extend to associations formed under unconstitutional statutes, but the decisions on that point seem few and about equally divided, Regarding the applicability of the principles of estoppel for the protection of the associates, there is no consensus. Some courts deny altogether that estoppel may arise. Others would confine estoppel to cases where the *de facto* doctrine exists. And still others would apply it independently of the *de facto* doctrine. There is less difference of opinion, but more confusion, upon the question of partnership liability. The view supported by the preponderance of judicial and text-book opinion, is that the association is *ex proprio vigore,* a partnership, and the associates are liable for its debts as partners, except perhaps in cases controlled by the *de facto* doctrine. It is believed, however, that most if not all of the cases in which the theory of partnership liability is put forth, are either equivocal

on their facts, or may be better explained on other principles of law; and most of the cases in which the question is really involved, repudiate or decline to apply the partnership theory.

The writer ventures to suggest that not a little of the mystification in which this subject is shrouded, is due to the notion still entertained by lawyers, that a corporation is a legal fiction and a mere creature of the law. This fiction or concession theory is not of common law origin, but was the invention of Pope Innocent IV and the civilians, and owes its popularity in this country to the celebrated dictum of Chief Justice MARSHALL in the *Dartmouth College Case,* which was based upon a misunderstood passage in the opinion of Lord COKE in *Sutton's Hospital Case.*[1] Often as the courts have repeated the phrase that a corporation is, "an artificial being, invisible, intangible and existing only in contemplation of law", it may be doubted whether they have rendered more than "lip service" to the fiction theory. A jurisprudence that recognizes corporations by prescription, the extraterritoriality of foreign corporations, the efficacy of *ultra vires* acts, ability of corporations to commit crimes, and the *de facto* doctrine, can hardly be said to "take much to heart" the idea that a corporation is a mere creature of the law. A corporation is indeed a real unit, just as is the state, a regiment in the army, a class in college or a bar association. It is what the German realists call a *"Gesammt person,"* a group person. Furthermore, whether a corporation is a fiction or a reality is not primarily a juridical question. "The question is at bottom not one on which law and legal conceptions have the only or the final voice"; says Professor GELDHART.[2] "It is one which law shares with other sciences, political science, ethics, psychology, and metaphysics * * * We cannot evade the legal question by treating legal personality as something which has no relation to the personality which is not matter of law but of fact."

What then are the true principles underlying the obligations of associates to third persons? Are the associates liable as partners? Are the principles of estoppel applicable, and if so to what extent? What is the basis and true scope of the *de facto* doctrine?

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[1] 10 Rep. 1, 32. See explanation of Sutton's Hospital Case in Sir Frederick Pollock's article, "Has the Common Law Received the Fiction Theory of Corporations?" (Law Quarterly Review, Vol. 27, p. 219) in which that learned writer "makes bold to answer," that "no English Court ever officially or unofficially adopted it."

[2] Lecture on Legal Personality, Law Quar. Rev. Vol. 27, p. 90, 94. Professor Geldhart supports the realty theory. See also Gierke's Political Theories of the Middle Ages, translated into English with an introduction by the late Professor Maitland, and see article "The Juristic Person, by G. F. Deiser, 48 Am. Law. Reg. (N.S.) 131, 216, and 300.

I.

While the "group person" is not created by law, the law may refuse to recognize it. This is the case in dealing with partnerships and generally with unincorporated companies. Legal recognition of the corporation, however, does not necessarily involve freedom from liability on the part of the members. For example, the stockholders are held personally if the corporate organization is used merely as stratagem to perpetrate fraud.[2a] The principal purpose of the statutes authorizing incorporation, nevertheless, is to enable business to be conducted upon a limited liability basis. The statute being for the benefit of the intending incorporators, it would seem that if they should attempt to incorporate but fail substantially to follow the requirements of the statute, they ought logically to be deprived of its protection and relegated to the position they would have occupied if there were no statute and no attempt had been made to incorporate. So, logically the liability of the associates or their freedom from liability, would depend upon the rules of positive law applicable to the transaction under investigation without reference to the attempted incorporation, and there would be no partnership liability as a matter of course. Indeed the associates might be in an even more favored position, for here as with many legal problems, logic is not the only factor. The associates are, indeed, in a more favored position. While the endeavor to incorporate may have been ineffectual, it must at times be recognized as a fact in much the same way as the judgment of a court which has been acted upon cannot be entirely disregarded, although the court was without jurisdiction.[3] To put it more concretely, third persons who have dealt with the association on a corporate basis, may be estopped to deny its corporate existence. The associates may be further protected by the *de facto* doctrine. This doctrine, it will be recalled, prevents collateral attack when there is a law under which the association might have been incorporated and an attempt has been made to become incorporated thereunder, resulting in a colorable corporate organization, coupled with an assumption and exercise in good faith of corporate powers by the associates who are sued as individuals.[4] The unsuccessful attempt to incorporate would not, therefore, penalize the associates, but might on the contrary redound to their advantage. In order then to ascertain whether the associates are personally liable for the obligations of the association, it is necessary

[2a] Donovan v. Purtell, 216 Ill. 629, 1 L. R. A. N. S. 176. See article Piercing the Veil of Corporate Entity, by Prof. I. M. Wormser, 12 Colum. L. Rev. 496.

[3] McClure v. Commonwealth, 80 Pa. St. 167.

[4] Prof. Warren, 20 Harv. Law Rev. 464.

to determine, first, whether in the absence of an attempted incorporation, they would have been personally liable under the rules of law governing the transaction in question, and secondly, assuming that they would be so liable, whether they are protected either by estoppel or the *de facto* doctrine. Such, it is believed, are the true principles upon which depend the liability of the associates to third persons.

II.

Passing now to the theory of partnership liability, it will not be disputed that the desire of the associates in a defectively incorporated association is not to form a partnership, and that, as between themselves, this desire will control.[5] There is, however, an irreconcilable conflict of opinion upon the question whether this desire of the associates not to form a partnership will prevent them from being held liable as partners at the instance of third persons who have dealt with the association.[6]

On the one hand Mr. MORAWETZ says:[7] "If an association undertakes to enter into a contract as a corporation, it is clear that the members of the association do not agree to be * * * bound as partners either to each other or to the party contracting with the association. It is equally clear, that the party contracting with the association does not intend to contract with its members individually. To treat the individual members of the association as parties to the contract, under these circumstances, would therefore involve not only the nullification of the contract which was actually contemplated by the parties, but the creation of a different contract, which neither of the parties intended to make." Mr. COOK says:[8] "The mere fact that an attempted corporation has failed does not necessarily render all the participants therein liable absolutely for all the debts of the concern. At most, each is liable only in the case he would be liable if the original plan had been to form a partnership." In *Humphreys* v. *Mooney*,[9] it was said: "The doctrine of a partnership liability in such case is not founded in law or reason, and is repugnant to the very purposes of the statute authorizing a corporation, one object of which is to limit individual liability." In *Rutherford* v. *Hill*,[10] the court said: "It is not doubted that cases might arise, and can readily be imagined, where the incorporators sought to be charged might take such part in conducting the business, or hold themselves out to

[5] Head v. Owen, 79 Ia. 23; Cannon v. Brush El. Co. 96 Md. 446, 94 Am. St. Rep. 598.
[6] See cases collected in Notes 32, 33, 34 and 35.
[7] Morawetz on Private Corporations, §748.
[8] Cook on Corporations, 6th Ed. §235.
[9] 5 Colo. 282.
[10] 22 Ore. 218.

the world as partners or as principals in the business, that they would be held liable; but this would grow out of their conduct in carrying on the business, and not out of the mere fact of signing and filing the articles."

On the other hand Mr. MACHEN says:[11] "that the authorities which hold that the associates are not liable as partners proceed upon the ground that the several members never intended to assume the position of co-partners and never held themselves out as occupying that relation, so that injustice would be done by treating them as such. But this argument, although specious, is believed to be fallacious. Although it is true that the members of the association did not intend to become partners, they did intend to engage in a joint enterprise as an associated body. Now the law knows but two forms of associations for business or trade—corporations and partnerships—and as they are not a corporation, they must be a partnership." Judge THOMPSON, with whom Professor BURDICK concurs, commended the theory of partnership liability as "the simple, just and easily applied doctrine."[12] In *Weir Furnace Company* v. *Bodwell*,[13] after citing cases thought to sustain the theory of partnership liability, the court said: "In these cases, the courts proceed upon the theory that if the associates cannot be treated as a corporation that they must necessarily be liable as partners irrespective of the agreement actually made." In *Meinhard etc.* v. *Bedingfield Mer. Co.*,[14] the court said: "There can be no corporate liability; so that if the defendants are not liable as a co-partnership, there is no liability."

Before attempting to choose between these conflicting views, let us first recall the essential elements of a partnership. "Except when one allows the public or individual dealers to be deceived by the appearance of partnership where none exists," said Mr. Justice COOLEY in *Beecher* v. *Bush*,[15] "he is never to be judged as a partner, unless by contract, and with intent, he has formed a relation in which the elements of a partnership are to be found. What are these? At least the following: Community of interest in some lawful commerce or business for the conduct of which the parties are mutually principals of and agents for each other with joint powers within the scope of the business, which, however, by agreement between the parties themselves, may be restricted at option to the extent even of making one the sole agent of the others and of the business."

[11] Machen, Modern Law of Corporations, §293.

[12] Thompson, Commentaries on Law of Corporations, §2992; Burdick, 6 Columbia Law Rev. pp. 1-14.

[13] 73 Mo. App. 389.

[14] 4 Ga. App. 176.

[15] 45 Mich. 188. See also Mechem, Elements of Partnership, §§1, 68.

"It is possible," the learned judge continues, "for parties to intend no partnership and yet to form one. If they agree upon an arrangement which is a partnership in fact, it is of no importance that they call it something else, or that they even expressly declare that they are not partners. The law must declare what is the legal import of their agreements, and names go for nothing, when the substance of the arrangement shows them to be inapplicable." In order, therefore, that there may be a partnership—barring cases of holding out as a partnership clearly inapplicable here—there must be an association created by contract express or implied in which the associates possess a community of interest in the capital furnished, and in the conduct of the firm business stand in the relation of principals and agents, usually mutual principals of and agents for each other; and the undertaking must be of a commercial character.

Does the defectively incorporated association meet these requirements? The question is, of course, not whether the associates desired to form a partnership, but whether they have done things from which the law will hold a partnership. The association is usually organized for a commercial purpose, but it obviously need not be. It may, for example, be formed for a civic purpose, as for building a public improvement. Do the associates stand in the relation of principal and agent to each other? Suppose one purchases, for investment, a few shares of stock in a large metropolitan bank—which it turns out is defectively incorporated—and does not participate in the business of the bank, even to the extent of voting his stock, either in person or by proxy. Is it not plain that such person is neither principal nor agent in the conduct of the business, but merely a contributor to capital?

It will be instructive at this point to notice two cases dealing with situations similar to those just suggested, namely *Johnson* v. *Corser*,[16] and *Stafford Bank* v. *Palmer*.[17]

In *Johnson* v. *Corser*,[18] the defendants had formed an improvement association for grading and improving a city street. They executed articles of incorporation, but before filing them, they engaged contractors to commence work upon the street. During the course of the latter's operations, their laborers struck, and two of the defendants, with the authority of the others, agreed with the laborers on behalf of the association to pay their wages if they would return to work. Action was brought against the associates upon this agreement. The plaintiff had judgment which

[16] 34 Minn. 355.
[17] 47 Conn. 443.
[18] 34 Minn. 353.

was affirmed on appeal. It will be observed that if the associates here had definitely set out to form a partnership, they would have been unsuccessful because of the non-commercial character of their undertaking. In the course of the opinion, the court said:

"The plaintiff asserts, as a rule of law applicable to the case, that, from the mere failure to perfect the contemplated incorporation, the association, after proceeding to carry on the proposed enterprise, became a partnership, and the members co-partners, with authority (implied from their relations) in each member to bind all of the associates by any act within the scope of the business carried on by the association. We cannot sanction the application to this case of the doctrine of implied agency as it is recognized in ordinary business co-partnerships. So far as appears, the business undertaken and carried on by the defendants was not of a partnership character, nor the purposes such as suggest the relation of co-partners between those engaged in it. * * * * * We deem the liability of the defendants to rest upon the ordinary principles of contract and agency, and not upon the ground of an existing co-partnership.

In *Stafford Bank* v. *Palmer*,[19] the directors of a Massachusetts manufacturing corporation decided to organize a corporation in Connecticut, and transfer to it the assets of the Massachusetts corporation. Steps were taken to that end, but it was claimed that the Connecticut statute was not followed. The transfer was effected and business carried on under the name of South Wilbraham Woolen Company. This was done without the knowledge of one Moulton, a stockholder who afterwards exchanged his stock in the old company for stock in the new, but never participated in the business. The plaintiff who had discounted the company's draft and had recovered 46 per cent. on a composition agreement, sued Moulton as a partner for the residue. The court held for the defendant on the theory that a non-participating associate is not liable as a partner. In the course of the opinion, it was said:

"Under the facts as found, can Moulton be held liable as a partner or in any other character? That he cannot be held liable as a partner on the ground of an express contract to become such is too clear for argument. If he is liable at all, it is by reason of some rule of law that imposes this liability upon him by implication from the facts found. The plaintiff's claim is that the South Wilbraham Woolen Company was illegally organized, that the members therefore became a partnership, and that Moulton was a stockholder in the company, and therefore liable as a partner. The facts

[19] 47 Conn. 443.

in this case do not warrant any such claim. In order to make one man liable for the acts of others, he must either directly or indirectly participate in the acts while they are being done or must authorize or direct them to be done beforehand or ratify and approve them afterwards. The pivotal inquiry is, what had Moulton to do with it, and how did his connection with it affect the right of these plaintiffs? A brief answer to this question is that he had nothing whatever to do with the organization or management of the company and knew nothing of it until long after its organization and his only connection with it then, was to receive a certificate of stock in lieu of his old certificate in the company just organized. This, and the single inquiry which he made about dividends, is his entire connection with the company. Does this make him liable? The bare statement of the question is sufficient to bring an answer in the negative from every honest man."

Clearly then, a defectively incorporated association does not necessarily contain the essential elements of a partnership. Indeed, it is doubtful whether upon approved principles, articles of incorporation would create a partnership, except in the rarest instances.[19a] The whole scheme for the conduct of corporate business is almost sure to be inconsistent with the nature of a partnership. The stockholders are given no voice in the management of the business, which is managed by the directors, who do not manage it as agents of the stockholders. The directors stand in a *sui generis* relationship to both the corporation and the stockholders. This relationship partakes of the character of principal, trustee and agent. As to the directors, the stockholders are not principals because they cannot control the discretion of the directors in the management of the corporate affairs. Between themselves, *qua* stockholders, the stockholders do not even stand in a fiduciary relationship for most purposes, much less in the relation of mutual principals and agents. It is hard to see, therefore, how articles of incorporation would create a partnership. It seems to follow that a defectively incorporated association would not be a partnership *ex proprio vigore,* unless it is held one by some arbitrary rule of law.

It might be suggested in this connection that careful draftsmanship may under familiar rules of the law of contracts and trusts, irrespective of any attempt to incorporate, place associates in an unincorporated company in a position as regards liability which for practical purposes is very little different from that of stockholders

[19a] It is not meant to suggest that small, defectively incorporated associations in which all the stock is held by those in active charge of the business might not frequently be conducted as partnerships, and the stockholders held as partners by estoppel. See Forbes v. Whitmore, 62 Ark. 229; Meinhard v. Bedingfield Mer. Co., 4 Ga. App. 176.

in a corporation. It is believed that much the same result follows an unsuccessful attempt to incorporate.

Addressing ourselves now to the arguments advanced in favor of the theory of partnership liability, we find two: (1) there is no intermediate form of organization between a corporation and a partnership, and (2) the associates would escape liability altogether if they were not held as partners.

Is not the argument that if an association is not a corporation, it must be a partnership, sophistical in the extreme? Might it not with equal force be contended that if a partnership is defectively formed, it must be a corporation?—which is, of course, absurd.[20] Is it true that there are no forms of organization known to the law other than the corporation and the partnership? Persons may be members of a voluntary society,[21] tenants in common,[22] or trustees and *cestuis que trustent*,[23] and as such, conduct their affairs without becoming partners or incurring partnership liability. It is not apparent why a relationship partaking of all these characters may not be created by contract.

Is not the argument that the associates must be held as partners or they will escape liability equally fallacious? This argument seems to be predicated, at least in part, upon the notion that the associates have been guilty of some dereliction in failing to meet the requirements of the incorporation laws, and that they should accordingly

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[20] 25 Harv. Law Rev. p. 634 n.

[21] "Members of clubs, associations and societies are not partners, though they possess business features and are conducted partly for pecuniary gain. Mr. Burdick in his Law of Partnership upon this point says;—'Naturally, therefore, there has been no hesitation on the part of Courts in declaring that societies and clubs organized and maintained for the promition of temperance, Lafond v. Deems, 81 N. Y. 507 (1880); for the enforcement of the laws, McCabe v. Goodfellow, 133 N. Y. 89; 30 Northeastern Reporter 728 (1892); for musical culture among their members, Danbury Cornet Band v. Bean, 54 New Hampshire, 524 (1874); for the propagation of political, social or religious doctrines, Richmond v. Judy, 6 Mo. Appeal 465 (1879); or even for mutual protection, Burt v. Lathrop, 52 Mich. 106 (1883); Brown v. Stoerkel, 74 Mich. 269 (1889); or insurance, Cohen v. N. Y. Mutual Life Insurance Co. 50 N. Y. 610 (1872)—are not partnerships, even though they may have for one of their objects the accumulation of property to be owned and enjoyed in common. It is not essential to the attainment of the objects which such associations have in view, that their members should severally possess the powers which the law merchant found it necessary to bestow upon each partner, such as the power of alienating firm property or of incurring firm obligations. Hence there is no foundation for a legal inference that the members of such associations possess those powers. On the other hand, it is uniformly held that the property rights and the legal liabilities of the members of these associations depend in the main upon their constitutions and rules, Cohen v. N. Y. Mutual Life Ins. Co. 50 N. Y. 611 (1872)'. Livingston v. Lynch, 4 Johnson Ch. (N. Y.) 573, 592. See, however, Cronkrite v. Trexler, 187 Pa. State, 100." English Ruling Cases, Vol. 19, p. 403.

[22] Robinson Bank v. Miller, 153 Ill. 244, 46 Am. St. Rep. 883.

[23] Mayo v. Moritz, 151 Mass. 481.

be punished. Could anything be further from the mark? The incorporation laws are designed for the protection of the intending incorporators, who, if they fail to bring themselves within the terms thereof, at most, it would appear, lose only the corporate shield. How can failure to follow the statute afford any reason why the associates should be struck down and penalized?

It must be admitted that the associates would escape liability in some cases if the theory of partnership liability fails, but only in cases where there is no legal basis for liability. Thus, as already suggested, non-participating stockholders in a defectively incorporated improvement association would not be held personally for the obligations of the association,[24] nor would small non-participating stockholders who had purchased stock in a metropolitan bank as an investment be held individually for all its debts in case it should become insolvent,[25] nor would one who acquired stock after the occurrence of the transaction upon which suit was brought, be held individually.[26] On the other hand, the directors or managing agents of the defectively incorporated association would be held personally on their implied warranty of the competence of their principal,[27] while a participating stockholder would be held personally as an undisclosed principal[28] and a non-participating stockholder might upon principles of estoppel be held upon a stockholder's statutory liability.[29] Indeed a non-participating stockholder might also be held liable as a partner by estoppel for failure to give notice of withdrawal from a partnership, which it was subsequently attempted to incorporate without success.[30] But this gives no sanction to the theory of general partnership liability because the non-participating stockholder who had been a partner might equally be held, if the firm was later duly incorporated without proper notice of dissolution of the partnership.[31] In brief, if the theory of *ipso facto* partnership liability falls, the associates would be held liable or freed from

[24] Johnson v. Corser, 34 Minn. 355.

[25] In re Western Bank & Trust Co. et al., 163 Fed. 713.

[26] Fuller v. Rowe, 57 N. Y. 23.

[27] Seeberger et al v. McCormick, 178 Ill. 404; Fay v. Noble, 7 Cush. 188; See Harrill v. Davis, 168 Fed. 187, 22 L. R. A. N. S. 153.

[28] Hoyt v. McClellen, 102 Ill. App. 287.

[29] Machen, §280, n2.

[30] N. Y. etc. Bank v. Crowell, et al, 177 Pa. St. 313.

[31] Reid v. Krelings' Sons Co., 125 Cal. 117; Rust-Owens Lumber Co. v. Wellman, 10 S. D. 122; Cook, 6th Ed. §243, p. 662, n. l. Lehman v. Knapp, 48 La. Ann. 1148. See also, Abbott v. Omaha Smelting Co., 4 Neb. 416; Liebold v. Green, 69 Ill. App. 527; Smith v. Wardens, 86 Mo. 382; Cincinnati Co-op. Co. v. Bates, 96 Ky. 356; Robinson v. First National Bank, 79 S. W. 103. (Tex. Civ. App.) Reversed in 98 Tex. 184. As already suggested the associates may make themselves liable as partners by estoppel. Forbes v. Whitmore, supra; Meinhard, etc. v. Bedingfield Mer. Co., supra.

liability in accordance with the rules of law appropriate to the litigation, which in most instances, would be the rules of the law of agency.

It remains to inquire into the state of the authorities upon the partnership theory. As suggested above, there is much contrariety of opinion upon this question, the greater number of the cases favoring partnership liability.[32] But an analysis of the cases discloses some surprising results. The cases placing the associates' liability upon partnership may be divided into two classes. In the first class it appears affirmatively in each case examined that the associates had participated in or authorized the transaction upon which they were held liable, or that they were directors or officers of the company.[33] In the second class, the report is silent in every case examined upon the question of participation.[34] After a somewhat extended search, the writer has not found a single case in which a non-participating associate, who had not authorized the transaction, was held to a general personal liability. Indeed, whenever the courts have been called upon to consider the case of non-participating associates, it appears that they have affirmatively held them not liable, and this has been true of courts which profess adherence to the theory of general partnership liability.[35] Is not this a *reductio ad absurdum*? The results reached in the first class of cases may be accounted for on principles of the law of agency, and in the second class the cases are equivocal on their facts. It appears, then, that in the only class of cases where an independent partnership liability might have a *raison d'être*, the courts have held that there is no liability. In other words, does not the theory of partnership liability as an independent rule of law break down when it comes to be applied?

The partnership theory cannot therefore be sustained upon legal

[32] Cases in support of partnership theory are collected in Notes 33 and 34. Cases contra are collected in Note 35.

[33] Garrett v. Richardson, 35 Ark. 144; Forbes v. Whitmore, 62 Ark. 229; Meinhard etc. v. Bedingfield Mer. Co., 4 Ga. App. 176; Loverin v. McLaughlin, 161 Ill. 417; (Also statutory liability) Hyatt v. Van Piper, 105 Mo. App. 664; Mandeville v. Courtwright, 142 Fed. 97; Brook v. Day, 129 Ga. 694; Eaton v. Walker, 76 Mich. 579; Worthington v. Griesser, 77 N. Y. App. Div. 203 (Also statutory liability).

[34] Perrine et al v. Levin et al, 123 N. Y. Supp. 1007; Standard Varnish Co., v. Jay, 149 Ill. App. 25; Bigelow v. Gregory, 73 Ill. 197; Louisville Nat'l Bank v. Henderson, 116 La. Ann. 413; Prourdurt Bank v. Suton, 116 La. Ann. 408.

[35] Farmers State Bank v. Kucks, 163 Mo. App. 606; Lucillo v. Pittelli, 127 N. Y. Supp. 314; Fuller v. Rowe, 57 N. Y. 23; Central City Sav. Bank v. Walker, 66 N. Y. 424; Harrill v. Davis, 168 Fed. 187, 22 L. R. A. N. S. 1153; In re Western Bank etc., 163 Fed. 713; Fay v. Noble, 7 Cush. 188; Trowbridge v. Scudder, 11 Cush. 83; Johnson v. Corser, 34 Minn. 355; Rutherford v. Hill, 22 Ore. 218; Second Nat'l Bank v. Hall, 35 Ohio St. 158; Bank v. Palmer, 47 Conn. 443; Churchill v. Thompson Electric Co., 119 Ill. App. 430.

principles, and the authority in support of it is unsatisfactory. The theory is equally repugnant to the requirements of justice and the needs of the business community, for it would subject the modest investor, who has purchased a few shares of stock in a great railroad, financial or industrial corporation which chanced to be defectively organized, to full personal liability for all the debts of the company. As was said by MEEK, D. J., in *In Re Western Bank Trust Company, et al.*[36] "In my judgment, it would be harsh and unjust to declare stockholders who became such after the concern was organized, who had nothing whatever to do with the management of its affairs, who were absolutely innocent of any wrong doing in relation thereto, to be partners in the concern, and to declare them personally liable in all its obligations and this simply because they were stockholders and had accepted the dividends declared on their stock. The immediate and inevitable consequence of such a holding here would be to inflict ruin on those who have not deserved it."

III.

Turning now to a consideration of the applicability of the principles of estoppel, it is generally conceded that an estoppel may arise between the associates themselves[37] or against a third person when the association sues as a party plaintiff upon a contract made in its assumed corporate capacity,[38] and that the associates may be estopped to deny that the association is a corporation,[39] but, as suggested above, there is a conflict of authority on the question whether third persons who have dealt with the association as a corporation are estopped to set up the individual liability of the associates.[40]

It is familiar learning that an estoppel may arise from a record, a deed or matter in *pais*; but it is not always remembered that estoppel in *pais* may arise from contract as well as from conduct amounting to a representation of fact made by one person and relied upon by another to his detriment. An estoppel may arise either from the execution of a contract or the performance thereof.[41] It arises from the execution of a contract when there is a stipulation in the contract to treat as true a fact assumed to be true. "Thus, dealing with a person on the footing that he occupies a particular position or character, it may be as administrator, executor, trustee, direc-

[36] 163 Fed. 713.
[37] Burdick, 6 Colum. Law Rev. p. 9.
[38] Lynch v. Pennyon, 29 Okla. 615.
[39] Slocum v. Steam Gas Pike Co., 10 R. I. 112.
[40] Cases cited in Notes 57, 58 and 59.
[41] Bigelow on Estoppel, 6th Ed., pp. 495-6; Oakland Paving Co. v. Rier, 52 Cal. 270; McClure v. Commonwealth, 80 Pa. St. 167.

tor, agent or holder of any manner of office, will estop that person, generally speaking, to deny the fact agreed or assumed in regard to his position or character. * * * * * So accepting and treating an article in shipment as express, may estop owner and carrier from treating it as freight. The estoppel in this class of cases is fixed by the execution of the contract. Nothing further need be shown where the fact in question is clearly agreed or assumed."[42]

The application of the principles of estoppel for the protection of the associates against third persons has been opposed on two grounds, (1) that the facts are not fairly within the scope of such principles,[43] and (2) if they be, to hold an estoppel would be contrary to public policy.[44]

Upon the first proposition, the opponents of the application of estoppel to these relations have had rather the better of the argument, due largely to the fact that its proponents have selected untenable ground. The latter have endeavored to bring the cases within the doctrine of estoppel by conduct. This has compelled them to resort to forced reasoning to make out a representation of fact by the third persons, relied upon by the associates to their detriment, to the effect that the incorporation laws had been followed by the associates. The argument as thus put, pertinently suggest the adversaries of the doctrine, involves a reversal in the order of things. When a third person deals with a defectively incorporated association, say they, there is no representation made by the third person, that he will treat the company as a corporation, which the company or the associates rely upon to their detriment; on the contrary, if there is any representation regarding incorporation, it is by the company and the associates, and if there is any reliance, it is by the third persons. Thus Mr. MACHEN says: "Many American courts—perhaps we should say, most American courts—hold not only that those who participate in representing to the public that a defectively incorporated company of which they are members is a legally constituted corporation are estopped to deny its corporate character, but also that anybody who deals with them as a corporation is likewise estopped. * * * * * This conclusion, it is submitted, cannot be justified by the ordinary principles of estoppel in *pais*. For the person or persons in whose favor the estoppel is invoked—that is,

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[42] Bigelow on Estoppel, ubi supra.

[43] Machen, §282, Prof. C. E. Carpenter, Article, De Facto Corporations, 25 Harv. Law Rev. 623, 631. My friend and former colleague Prof. Carpenter, authorizes me to say that he agrees with the analysis of estoppel made in the text, notwithstanding that he took a different view in the article just cited. In dealing with the partnership theory, I have availed myself of several suggestions kindly made by Prof. Carpenter.

[44] Boyce v. Trustees, 46 Md. 359.

the supposed corporation or its members—were not misled by any misrepresentation of the person who is to be estopped. If we assume that whoever deals with a company which claims to be a corporation impliedly represents to it that it is incorporated, yet the supposed company or its members are not misled; for they are better acquainted with the facts than he can possibly be."[45]

If the estoppel of the third person depends upon principles of estoppel by conduct, it is difficult, if not impossible, to meet this reasoning. But the reasoning does not touch the question whether there may be an estoppel by contract. That question, it would appear, has not received adequate consideration at the hands of either the courts or theoretical writers. There are, however, suggestions indicating that the estoppel herein arises from contract. Thus, in *Slocum* v. *Head*,[46] the court said: "The immunity of the associates is founded upon good faith and upon estoppel of those who deal on the basis of one situation to maintain another for the purpose of enforcing demands to which they did not believe themselves entitled." Professor WARREN has observed:[47] "The associates expected to be shielded, by their possession of the corporate privilege, against unlimited liability for a breach of the contract, and A. (the third person who dealt with the association) may fairly be charged with knowledge of this. In consenting to contract with them as a corporation, he has, by necessary inference consented to avail himself on a breach of contract of only such remedies as could be used if the associates possessed the corporate privilege."

If at the time of contracting and as a part of the contract, it is agreed in terms that the association is to be treated as a corporation and in case of litigation the creditor is to look only to the assets of the association, it would probably be admitted by all that the third person could not hold the associates individually,[48] but it is not often that such an explicit stipulation is found in the contract between the association and the third person. Indeed, as a general thing, there is no express stipulation governing the matter Does this alter the situation? Professor BURDICK seems to be of the opinion that it does.[49] He says: "If the stockholders had desired to shield themselves by a contract, when they had not shielded themselves by validly incorporating, they should have secured from the creditor a clear and express stipulation that he would look only

[45] Machen ubi supra.

[46] 105 Wis. 431.

[47] 20 Harv. Law Rev. 475-6.

[48] See Imperial Shade etc. Co. v. Jewett, 169 N. Y. 143; Kent's Commentaries, Vol. 3, p. 27; Lindley on Partnership, 5th Ed. p. 27; Burdick, 6 Col. L. Rev. p. 7.

[49] 6 Colum. Law Rev. p. 7.

to the pretended corporation, or to its assets, for satisfaction of his claim."[50] Among authorities adduced by Mr. BURDICK in support of his position is *Hess et al.* v. *Woertz*,[51] which is representative of the authorities he cites. In that case, the question was whether or not a partnership engaged in the banking business had limited its liability by stipulation. In holding that it had not, GIBSON, J., said: "I see no reason to doubt, but that they may limit their responsibility, by an explicit stipulation, made with the party with whom they contract, and clearly understood by him at the time. But this is a stipulation so unreasonable on the part of the partnership, and affording such facility to the commission of fraud, that unless it appear unequivocally plain, from the terms of the contract, I will never suppose it to have been in the view of the parties. Unless the contrary clearly appeared, I would not suppose anyone so imprudent, as to contract solely on the credit of a fund, exclusively within the control of another, and of the solvency of which he could not command the means of obtaining a knowledge."

It is submitted that there may be a term in the contract limiting liability inferred from evidence other than that found in an express stipulation, and that cases such as the one just referred to are not contrary to this view. There is a vast difference between the situation of one dealing with persons confessedly acting as partners, and that of one dealing with persons who, it is supposed on both sides, are doing business under corporate form. Certain inferences of fact that might be drawn in the one case, clearly could not be drawn in the other. *Hess et al.* v. *Woertz* and similar cases, it is believed, really deal with questions of evidence, and deal with them correctly.[51a] The fallacy in Mr. BURDICK'S argument, it is suggested, lies in this,—it disregards the elementary legal proposition that a contract implied in fact is equally as efficacious as an express contract. The difficulty of proof in the case of dealings between third persons and the association where an express stipulation limiting liability is wanting, is no more marked than in many other cases where the inquiry is whether there is a condition or contract implied in fact. Whether or no there be an express stipulation, the legal question is the same, namely, has there been a meeting of minds, in the legal sense, upon the proposition to limit liability?

It then appears that the elements of an estoppel may be present. Is it against public policy to permit an estoppel? Inasmuch as the

[50] Ibid.

[51] 4 Serg. & R. 356.

[51a] Creditors may be estopped to question that a general partnership is a limited partnership. Tracy v. Tuffly, 134 U. S. 206.

estoppel, if any, is an incident of the contract—somewhat in the nature of a spontaneous injunction[52]—the question resolves itself into the inquiry, is a contract to treat an association as a corporation for the purpose of limiting liability contrary to public policy?[52a] The remark of an English judge that "public policy is an unruly horse" is worthy of attention here, and it will be recalled that those asserting that a contract is against public policy must suggest some definite rule of public policy. They must show that the contract is either for an end forbidden by statute, the rules of the positive law or the settled policy of the law as indicated by the decisions of the courts. And as Sir G. JESSEL, M. R., observed in a now celebrated passage:[53] "It must not be forgotten that you are not to extend arbitrarily those rules which say that a given contract is void as being against public policy because if there is one thing, which more than another, public policy requires, it is that men of full age and competent understanding shall have the utmost liberty of contracting and that their contracts when entered into freely and voluntarily shall be held sacred, and shall be enforced by courts of justice. Therefore, you have this paramount public policy to consider, that you are not lightly to interfere with this freedom of contract."

Applying these familiar principles, the estoppel would fail if there was a statutory provision forbidding persons not incorporated from engaging in a particular business, as the banking business,[54] for the estoppel would be in contravention of the statutory mandate. Likewise, there would be no estoppel where the statute made associates in a defectively incorporated association personally liable for its debts.[55] But—in the absence of statute—is there any public policy against estoppel applicable to defectively incorporated associations generally? The policy of the common law requiring special charter or legislative enactment for the creation of limited companies is clearly not relevant. That policy is directed against A. and B. making a contract *inter sese* which attempts to limit their liability as to X. It has nothing to do with a contract between A. and B. on the one hand, and X. on the other by the terms of which the liability of A. and B.

[52] "A learned judge has said that estoppel was a device of the common law courts worked out through the system of special pleading, to strengthen and lengthen the arm of the law judges, and so to enable them to do what the Court of Chancery has always done unaided." Bigelow on Estoppel, 6th Ed. p. 492, referring to the observations of Bacon, V. C., in Keate v. Phillips, 18 Chan. Div. 560, 577.

[52a] Railroad Company v. Yorke etc. Co., 102 N. E. 366 (Mass.); Bigelow on Estoppel 6th Ed. p. 495 Note—

[53] In Printing etc. Co. v. Sampson (1875) L. R. 19 Eq. 462, 44 L. J. Ch. 705.

[54] Jones v. Aspen Hardware Co., 21 Colo. 263.

[55] Heuer & Brock Schmidt v. Carmichael, 82 Ia. 288; Loverin v. McLaughlin, 161 Ill. 414.

is limited as to X. It would serve no useful purpose to pursue this inquiry because the courts from very early times have upheld contracts limiting liability by appropriate stipulation, even in the case of common carriers; and this principle of law would appear clearly applicable to partnerships and unincorporated associations.[56]

A word may be added regarding the application of the foregoing principles. The mere fact that a third person has dealt with the association under its corporate name would obviously be insufficient to raise an estoppel because such fact standing alone would be equivocal. Thus, of the thousands of persons who daily do business with the American Express Company, very few indeed must stop to consider whether it is a corporation or a partnership. It is suggested that the least that should be sufficient to raise an estoppel ought to be a showing that the associates assumed to do business as a corporation and the third person, as a reasonable man, understood that he was dealing with the association as a corporation. And this, it would seem, ought to be enough, in practically all cases, for such dealing would carry to the ordinary mind an implication of limited liability on the part of the associates, and would, therefore, show assent to a tacit stipulation to look only to the funds of the association in case of litigation. While it is believed that this is the correct analysis of the problem, it is only fair to say that apparently it has never been suggested by the courts.

There is a tendency at the present time to repudiate the doctrine of estoppel as a shield for the associates from third persons,[57] or to limit it to cases of *de facto* corporations.[58] This is probably due, in part, to the misapprehension that the *de facto* doctrine is founded upon estoppel, and that there is a partnership liability unless the association is within the *de facto* doctrine. The *de facto* doctrine, as will be shown presently, is independent of estoppel and of much broader scope. When it is available as a defense, there is no occasion to invoke estoppel. The cases holding that there may be an estoppel independently of the *de facto* doctrine,[59] for this reason and the reasons given above seem sound in principle.

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[56] See cases cited in Note 48.

[57] Owensboro Wagon Co. v. Bliss, 132 Ala. 253, 90 Am. St. Rep. 907; Note 11 Columbia Law Rev. 160; Cincinnati Cooperage Co. v. Bates, 14 Ky. Law Rep. 469; See McVicker v. Cane, 21 Ore. 353.

[58] Imperial Bld. Co. v. Chicago Open Bd. of Trade, 238 Ill. 100; Davis v. Stevens, 104 Fed. 235; Jones v. Aspen Hardware Co., 21 Colo. 263.

[59] Tulane Improvement Co. v. S. A. Chapman Co. 129 La. Ann. 562; Bond & Bushnell v. Scott Lumber Co., 128 La. Ann. 818; Guckert v. Hucke 159 Pa. St. 303; Carroll v. Pac. Nat. Bk., 19 Wash. 639; Jennings v. Dauer, 175 Ind. 332.

It need scarcely be added that the principles of estoppel when applicable protect the directors, managing agents, and active stockholders as well as the non-participating stockholders. Arising from contract, estoppel is not, of course, generally available in actions of tort brought against the associates.

IV.

This brings us to the last division of our subject—the doctrine of the *de facto* corporation. The term *de facto* corporation is, of course, used in contrast with the term *de jure* corporation. It will be recalled that not every defect in organization prevents a corporation from being *de jure*. If there has been substantial compliance with the mandatory provisions of the statute prescribing conditions precedent to incorporation, a defectively incorporated association may be a corporation *de jure* even though there are defects in its organization relating to directory provisions of the statute or provisions imposing conditions subsequent to incorporation.[60] In common parlance, any defectively incorporated association, not measuring up to the stature of a *de jure* corporation, which has assumed to do business as a corporation, would be regarded as a corporation *de facto*. The term *de facto* corporation, however, is used in law in a technical sense. In the technical sense, an association is not a *de facto* corporation unless it has met certain more or less artificial requirements laid down by the courts. Perhaps the best statement of these requirements is found in a recent essay from the pen of Professor WARREN,[61] who says, "if associates have made an attempt to incorporate resulting in a colorable corporate organization under a law authorizing the formation of such a corporation as was attempted and there has been use of some of the powers which such a corporation would possess and the persons seeking to prevent collateral attack have acted in good faith, [there is a corporation *de facto* in the technical sense."] The usual statement of the *de facto* doctrine is that a corporation *de facto* in the technical sense exists when there is a law under which the association might have been incorporated and a bona fide attempt has been made to become incorporated thereunder, resulting in a colorable corporate organization, coupled with an assumption and exercise of corporate powers. Mr. WARREN'S statement is superior in that it covers the case where the organizers of the enterprise have failed to act in good faith, but the enterprise has passed into the hands of innocent purchasers who

[60] Machen, Modern Law of Corporations, §264.
[61] 20 Harv. L. Rev. 464.

have, themselves, in good faith, continued to conduct the affairs of the association in the belief that it was a corporation.[62]

The effect of the *de facto* doctrine is to prevent collateral attack upon the corporate existence of the defectively incorporated association either by private parties or the state, except in eminent domain cases under some authorities, and excepting such cases, the associates stand in the same position so far as third persons are concerned as the members of the *de jure* corporation. The state may, of course, in a direct proceeding oust the associates from exercising corporate powers.[63]

Many difficulties arise in the application of the *de facto* doctrine. The bona fides of the associates often involves a difficult mixed question of law and fact. What constitutes a colorable corporate organization is not easy to determine. The decisions seem to afford no real test. At present, the question, it is believed, can be determined only by a resort to the adjudicated cases and the analogies that may be drawn therefrom.[64] It may be that eventually from judicial inclusion and exclusion, the courts will supply some criteria which will yield to generalization. As yet, this has not been done. A further question, and one to which we shall confine our discussion, is whether an unconstitutional law may afford sufficient foundation for the *de facto* doctrine.

Upon this question the authorities are in conflict. The weight of judicial dictum is to the effect that there cannot be a *de facto* corporation unless there is a constitutional statute under which a corporation *de jure* might have been formed. But the decisions on the point seem few and about equally divided.[65] It will be found that most of the cases usually cited in support of the prevailing view, contain only dicta or deal with the doctrine of *de facto* public officers.[65a] While it is true that the majority of cases hold that an unconstitutional statute will not create a de facto office,[65b] it is also generally held that a municipal corporation may be created *de facto*

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[62] Methodist Church v. Pickett, 19 N. Y. 482; Finnegan v. Norenberg, 52 Minn. 239; Clark v. American Carmel Coal Co., 165 Ind. 213.

[63] See American Co. v. Heider Heimer, 80 Tex. 344; Minor v. Mechanics Bank, 1 Pet. 46, 66.

[64] See monograph note in 118 Am. St. R. 253 collecting the cases.

[65] An unconstitutional statute was held insufficient basis in Clark v. Amer. etc. Co., 165 Ind. 213; Eaton v. Walker, 76 Mich. 581.

Contra: Coxe v. Saxe, 144 N. Y. 396. There may, of course, be an estoppel to question the de facto corporate character of the association. Bradley v. Keppell, 133 Mo. 545; McCarthey v. Lavosche, 89 Ill. 270.

[65a] See cases cited in Machen on Modern Law of Corporations, §286.

[65b] Hall, Cases on Constitutional Law, p. 49, n. 3, citing note in 15 L. R. A. N. S. 94—107.

by an unconstitutional statute.[65c] So it may be doubted whether analogies can be drawn from public law.

As a preliminary to determining which of the above views is correct on principle, let us inquire as to the legal basis for the *de facto* doctrine. Here, too, we find difference of opinion. It was at one time thought by not a few that estoppel afforded the basis for the doctrine.[66] This view is generally rejected at the present time.[67] The opinion now held in most authoritative circles is that the *de facto* doctrine is an independent doctrine based upon definite considerations of public policy.[68] An interesting and novel view recently put forward by Professor WARREN is that the doctrine is based upon estoppel together with certain "extenuating circumstances."[69]

Before choosing between these theories, it might be well to indicate a few representative states of fact to which the doctrine has been applied. It has been held that a *de facto* corporation may maintain ejectment against a stranger to its title[70] or an action of tort against a trespasser;[71] that it may be a conduit of title;[72] that it may not be wound up as a partnership;[73] that a statute applicable to "unincorporated companies" does not apply to *de facto* corporations;[74] that a *de facto* corporation is aptly described in an indictment charging embezzlement from an "incorporated company;"[75] that the stockholders in a *de facto* corporation are individually liable under a statute imposing liability upon "corporate stockholders;"[76] that the stockholders of a *de facto* corporation are not individually liable for a tort committed by the corporation.[77] It would be idle to attempt to explain these decisions by reference to estoppel. The difficulty with Mr. WARREN'S theory of "extenuating circumstances," as pointed out by Professor CARPENTER,[78] is that a new extenuating circumstance must be sought in each case where estoppel is an insufficient explanation, and this presents no

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[65c] Id. citing 28 Cyc. 172 (cases), 28 Cyc. 1391 (cases), 15 L. R. A. N. S. 105—107.

[66] See for example Sniders' Sons Co. v. Troy 91 Ala. 224; Bushnell v. Cons. Ice M. Co., 138 Ill. 167; Machen, §291, n. 4.

[67] Society Perum v. Cleveland, 43 Oh. St. 481.

[68] See Machen, Modern Law of Corporations, §291; Morawetz, Private Corporations, §652, 744.

[69] 20 Harv. Law Rev. 456.

[70] 20 Harv. Law Rev. 471 note 20, citing cases.

[71] Ibid.

[72] Marion Sav. Bank v. Dunkin, 54 Ala. 471.

[73] Machen, Modern Law of Corporations, §292.

[74] Ibid.

[75] People v. Carter, 122 Mich. 668.

[76] Machen, ubi supra.

[77] Demorest v. Flack, 32 N. Y. St. Rep. 675 affd. 128 N. Y. 265.

[78] 25 Harv. Law Rev., 623.

superiority over the clean cut *de facto* doctrine while it may involve no little superfluous labor. The true explanation of the *de facto* doctrine is found, it is believed, in the following from MACHEN on "THE MODERN LAW OF CORPORATIONS."[79] "The doctrine of *de facto* corporations does not rest on estoppel, but on that public policy which is thought to prohibit the annulling of a company's acts because of some technical flaw which none but a skilled lawyer could detect."

If the purpose of the *de facto* doctrine is to deal with effects and not causes,[80] and if the doctrine is based upon the public policy directed against the annulling of the company's acts because of a technical flaw that none but a skilled lawyer could detect, why should it not be applied where the incorporation law has been declared unconstitutional? The argument against applying it in such cases is that the policy of the common law against unincorporated limited companies is not changed by an unconstitutional act authorizing the formation of corporations, because an unconstitutional act is not a law at all. This position is not without force. In the leading case of *Norton* v. *Shelby County*,[81] which involved the question whether an unconstitutional statute might create a public office, it was said by Mr. Justice FIELD: "An unconstitutional act is not a law; it confers no rights, it imposes no duties; it affords no protection and creates no office; it is, in legal contemplation, as inoperative as though it had never been passed." With great deference, it is submitted that this statement goes much too far. While, of course, the courts will not enforce an unconstitutional statute, they do not entirely disregard it. Thus an inferior judicial officer acting under the authority of an unconstitutional statute may claim his immunity;[82] likewise, an officer acting under a writ fair on its face, but issued under an unconstitutional statute, is protected thereby,[83] nor is an officer indictable for obeying an unconstitutional law;[84] and an unconstitutional statute may permit the discharge of a moral obligation which would other-

[79] §291.

[80] "The authorities are in harmony that the de facto doctrine was invented to deal with effects, not with causes. The effects only can be reached. The causes cannot. The official acts are accomplished; if the effects are alike, it is immaterial that the causes differ. The effects, whether from a de jure or de facto office are alike. Hence, the acts of the officer occupying either position should be declared de facto." Spear, J. in State v. Paulin 105 Me. 224, 231, 15 L. R. A. N. S. 93.

[81] 118 U. S. 425. On the effect of unconstitutional statutes generally, see excellent notes in Hall's Cases on Constitutional Law, p. 49-53. The writer acknowledges his indebtedness to these notes.

[82] Brook's v. Mangan, 86 Mich. 576; Hayes v. Hutchinson & Shields, (Wash.) 142 Pac. 865.

[83] Anheuser Busch etc. v. Hammond, 93 Ia. 520.

[84] State v. Godwin, 123 N. C. 697.

wise be beyond the province of government.[85] As was said by COLLINS, J., in *Allison* v. *Corker*:[86]

"An unconstitutional statute is nevertheless a statute; that is, a legislative act. Such a statute is commonly spoken of as void. I should prefer to call it unenforcible because in conflict with paramount law. * * * * * The function of the judicial department with respect to legislation being unconstitutional is not exercised *in rem,* but always *in personam.* * * * * * An unconstitutional statute is not merely blank paper. The solemn act of the legislature is a fact to be reckoned with. Nowhere has power been vested to expunge it or remove it from its proper place among statutes."

To sum up, the associates in defectively incorporated associations are not easy prey to everyone who has dealt with the association. On the contrary, they occupy a place of vantage. They are only liable to third persons when there is a recognized ground of legal liability, irrespective of the unsuccessful attempt to incorporate; and such unsuccessful attempt instead of working to their destruction, often affords safety as it may bring them within the protection of the *de facto* doctrine or principles of estoppel.

From a practical standpoint, the results of our investigation are:

(1) The non-participating associates are not liable, save by statute or by reason of a holding out as partners.

(2) The active associates, directors, and officers generally would be liable under the principles of agency unless protected by estoppel or the *de facto* doctrine.

(3) Estoppel to question the association's corporate existence, being founded on contract, arises only when there is a stipulation, express or tacit, to treat the association as a limited liability corporation.

(4) The *de facto* doctrine, resting upon public policy, extends its protection to matters *ex delicto* as well as *ex contractu* and should prevail even where incorporation has been attempted under an unconstitutional statute.

This analysis of the liability of the associates to third persons may not be as "simple and easy of application" as the partnership dogma, but legal problems do not always yield to rules of thumb.

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[85] U. S. v. Realty Co., 163 U. S. 427. It has been held that equity will relieve against a judgment in case one of the litigants has relied upon a statute later declared to be unconstitutional. Cobb v. Colman, 14 Tex. 594.

[86] 67 N. J. L. 600.